



WRITTEN STATEMENT

BEFORE THE U.S. SENATE COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

HEARING ON

“EXPANDING OPPORTUNITIES FOR SMALL BUSINESS THROUGH THE TAX CODE”

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Chairman Risch, Ranking Member Cardin and fellow members of the Committee,

Thank you for inviting me to speak with you today about opportunities for entrepreneurship throughout America.

I was a long-time small business owner prior to founding Small Business Majority 12 years ago. For 13 years, I was the founder and CEO of ACI Interactive, an award-winning interactive communications company, and earlier I was the chief operating officer of a pioneering multimedia business. Following my years of experience running small businesses, I founded Small Business Majority to create a national organization to serve as a leading advocate for America’s entrepreneurs.

Small Business Majority’s mission is to empower America’s entrepreneurs to build a thriving and inclusive economy. We actively engage small business owners and policymakers in support of public policy solutions, and deliver information and resources to entrepreneurs that promote small business growth and drive a strong, job-creating economy. Our extensive scientific opinion polling, focus groups and economic research help us educate and inform policymakers, the media and other stakeholders about key issues impacting small businesses and freelancers, including access to capital, taxes, healthcare, retirement and critical workforce issues.

Small Business Majority has a network of 58,000 small business owners across the country, with eight regional offices. We work closely with our network and with more than 1,000 local business groups to create a strong small business voice in Washington and state capitals, and deliver critical education and resources to America’s job-creating entrepreneurs. Through our Entrepreneurship Program, we offer free education, tools and events to small business owners and aspiring entrepreneurs about access to responsible lending options, retirement, healthcare, wealth building tactics and more.

A thriving small business ecosystem is central to creating a dynamic and inclusive American economy. America’s 30 million small businesses represent 99% of all employer firms and account for half of our nation’s jobs and economic output, and their creativity spurs innovation in all sectors of the economy. According to the U.S. Small Business Administration, small businesses have created

two out of three new private-sector jobs since the Great Recession.¹ Private-sector job creation at small- and medium-sized businesses has outpaced the rate of large-size companies for every month of 2017, per ADP's National Employment Report.²

It is because of this undeniable importance that the decline in the rate of business formation is particularly troubling. According to the U.S. Census Bureau, 414,000 startups were created in 2015, down from the pre-recession average of 524,000 between 2002 and 2006, a roughly 25% decline.³ That translates to fewer jobs created by startups, and less innovation in our economy. We must pursue and enact policies that will reverse this trend and enable entrepreneurs to unleash their potential and boost prosperity for all.

The 2017 Tax Cuts and Jobs Act was a missed opportunity to encourage entrepreneurship and streamline policies that reduce red tape for our nation's small business owners. Indeed, we believe the law will hurt small businesses and the economy because it will increase the deficit by \$1.5 trillion without giving Main Street a real tax break. Despite the failure to enact meaningful tax reform for our nation's entrepreneurs with the Tax Cuts and Jobs Act, there are numerous concrete tax policies legislators should consider to expand opportunities for small businesses, especially for our nation's 22 million solo entrepreneurs.

The 2017 Tax Cuts and Jobs Act left Main Street small businesses behind

The Tax Cuts and Jobs Act was written to the benefit of large corporations and wealthy individuals, not Main Street small businesses. A priority of this legislation was to slash corporate tax rates from 35% to 21% even though only 5% of small businesses pay corporate taxes.⁴ Adding \$1.5 trillion to the deficit at a time of economic prosperity will do nothing to help small businesses, and it certainly doesn't level the playing field.

Additionally, the law's treatment of pass-through entities gives the bulk of the benefit to the wealthiest pass-through entities, rather than Main Street. Indeed, data from the Joint Committee on Taxation (JCT) reveals a whopping 44% of the new pass-through deduction (\$17.8 billion) will benefit approximately 200,000 individuals making \$1 million or more.⁵ In 2024, this will increase to \$31.6 billion.

According to the JCT report, the majority of the 2018 tax reduction benefit will go to the top 2.3% of pass-through firms, and by 2024 that percentage drops to one percent.⁶ A business owner with \$600,000 per year will save almost 25 times that of an owner with \$75,000 in income, despite only earning eight times more. According to the Small Business Administration, the median income for individuals self-employed at their own incorporated businesses was \$50,347 in 2016.⁷ It is also important to note that not all pass-through businesses are small firms: According to the Tax Policy Center, less than two percent (1.7%) of all pass-through businesses, with average profits of three-

¹ Small Business Administration FAQs, June 2016, https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf

² ADP National Employment Report, January-August 2017, <http://www.adpemploymentreport.com/>

³ "A Start-Up Slump Is a Drag on the Economy. Big Business May Be to Blame," *The New York Times*, September 2017, <https://www.nytimes.com/2017/09/20/business/economy/startup-business.html>

⁴ Brookings Institution, "Nine facts about pass-through businesses," May 2017, <https://www.brookings.edu/research/9-facts-about-pass-through-businesses/>

⁵ Joint Committee on Taxation, "Tables Related to the Federal Tax System as in Effect 2017 through 2026," April 2018, <https://www.jct.gov/publications.html?func=startdown&id=5091>

⁶ Ibid.

⁷ Small Business Administration, 2018, <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf>

quarters of a million dollars, account for the majority of all pass-through income—hardly your typical Main Street small business.⁸

Jessica Jolly, a solo-entrepreneur in Illinois and a member of our Small Business Council, told us that she doesn't feel the tax law did anything to help incentivize small business growth or retention, particularly for people like her—independent small business owners in their 50s and 60s who are leaving the corporate world but not ready for retirement. She noted that rather than wasting resources by giving corporations a break, the tax system should encourage more people to start businesses or to become solo-entrepreneurs.

Policymakers missed a once-in-a-generation chance to craft tax reform that would have made life easier for America's small businesses. This is why we proposed a different solution that would have benefitted small businesses from the "bottom up" during the debate over tax reform last year. Specifically, we proposed allowing small businesses to deduct their first \$25,000 in business income whether or not they file their tax returns as a pass-through entity or as a C-Corporation. This would have ensured that changes to the tax code would have a significant, direct benefit to small businesses and self-employed individuals as opposed to large businesses, hedge funds and the very wealthy.

A proposal like this appealed to Nancy Clark, a member of our Small Business Council and owner of Drive Brand Studio, a small business focusing on marketing and PR in New Hampshire. She noted that the 2017 tax cuts didn't do anything for her as a small business owner, and that a bottom-up tax approach would have helped small businesses by allowing them to truly reinvest in their business. She added that legislation should instead focus on creating tax rates that benefit small businesses of all sizes to help them compete with big business. She said, "I truly believe the tax law was never meant to benefit true small businesses like me. It's unfortunate for me and my fellow New Hampshire small businesses because 'mom and pop' shops and small local firms like mine are the backbone of this state and our country. To see the tax law not provide support for us is truly disappointing, to say the least."

Tax cuts are too complicated, allow for more loopholes and won't spur investment

The tax cuts are structured in a way that is convoluted and benefits those at the top far more than lower-income business owners, with the majority of benefits going to the wealthiest pass-through business entities. Small business owners who do see any benefit will not receive enough savings to grow or invest back in their businesses.

A report co-authored by Anne Zimmerman, a member of our national Small Business Council who owns a small public accounting firm in Ohio, found the 20% deduction on qualified business income is unlikely to generate enough savings for real small businesses to hire new employees, invest back into their businesses or make operational improvements.⁹ Additionally, recent polling from ZipBooks, an online accounting software company that serves more than 100,000 small businesses, found 88% of small business owners say the new tax cuts have had no impact on their hiring decisions.¹⁰

⁸ Tax Policy Center, "Distribution of Business Income, by Statutory Marginal Tax Rate; Current Law, 2017," March 2017, <https://www.taxpolicycenter.org/model-estimates/distribution-business-income-march-2017/distribution-business-income-statutory>

⁹ Businesses for Responsible Tax Reform, "The Tax Cuts and Jobs Act: Implications for Small Businesses," May 2018, https://docs.wixstatic.com/ugd/4a8609_5ae6299d49534af6b27acb872d044e30.pdf

¹⁰ ZipBooks, "Tax cuts advertised to fuel spending on jobs, yet small business owners feel differently," September 2018, <https://zipbooks.com/blog/tax-cuts-impact-on-small-business-owners/>

The complexity of the new deduction means that any savings will likely go towards tax professionals to help entrepreneurs navigate their taxes. Small Business Majority member Clifton Broumand, Owner of Man & Machine Inc., a medical keyboard and mouse manufacturer in Landover, Maryland, noted that he feels like the tax bill was designed for businesses at the top of the food chain, not small businesses like his. He added that the process of filing taxes has gotten even more difficult, and he has seen no benefit or savings from the tax law.

Given these sentiments, it's not surprising that the National Small Business Association found in a recent survey of its members that a mere 7% say they think filing taxes will become easier under the new tax law, and 1 in 3 say they already spend more than 40 hours each year on federal taxes.¹¹ An additional 1 in 3 say businesses plan to, or are considering, switching from a pass-through entity to a C-Corporation as a result of the Tax Cuts and Jobs Act, with the majority saying the temporary nature of the small business tax cuts is an issue for their business.

And importantly, a tax code with a large gap between top individual rates and top pass-through rates will encourage some wealthy individuals to game the system by simply declaring themselves pass-through business entities. While the new law exempts certain industries from accessing the pass-through rate, there is no way to guard against all abuse of the pass-through rate and ensure that this does not primarily benefit hedge fund managers, lobbyists, lawyers and investment bankers—rather than Main Street small businesses.

Simply put, small business owners wanted a simplified and more streamlined tax system that would also help level the playing with large corporations, and they got the opposite.

Policy recommendations to better serve our nation's entrepreneurs

Now that the 2017 Tax Cuts and Jobs Act is established law, we must turn to concrete policy solutions that could better serve our nation's entrepreneurs within the reformed system. This includes the following recommendations:

- **Ensure Opportunity Zones guidelines are designed to benefit Main Street small business owners rather than focusing on incentivizing real estate development.** As to date, little detail has been revealed about how investments in Opportunity Zones enacted by the 2017 Tax Cuts and Jobs Act will be implemented. While these investments hold the potential to benefit small businesses, especially those in underserved communities, they must be implemented responsibly. This could include requiring reporting metrics that measure program success based on the number of jobs created, where those jobs are located, employee wages and the number of businesses created, particularly businesses formed by women or people of color.
- **Make the New Markets Tax Credit permanent.** This tax credit, which is set to expire at the end of 2019, has helped attract more than \$60 billion in private sector funding to build businesses in economically-distressed communities across the United States.
- **Align form 1099 reporting thresholds and streamline income reporting for independent workers.** Independent workers receive either a Form 1099-MISC or a Form 1099-K depending on how they are paid—if they are paid via cash or check, they receive a 1099-MISC if they are paid \$600 or more. However, if they are paid electronically, they only receive a 1099-K if they receive at least \$20,000 in payments and are involved in more than 200 transactions with that network. These independent contractors are still required to pay taxes on income received below this threshold, but are expected to track and report their own

¹¹ National Small Business Association, 2018 Small Business Taxation Survey, <http://nsba.biz/wp-content/uploads/2018/04/Tax-Survey-2018.pdf>

earnings without documentation, which increases the likelihood that an independent contractor could misreport their earnings and leaves them vulnerable to costly penalties. Aligning the reporting requirements so all independent contractors receive documentation for income above \$600, regardless of how they receive that payment, could ease their administrative burden while also increasing compliance.

- **Identify and fix tax issues unique to micro-enterprises and freelancers, such as burdensome quarterly tax filings for freelance employees.** These quarterly filing requirements, mandatory for any freelancer who will owe more than \$1,000 annually to the IRS, are burdensome and leave independent workers vulnerable to costly fees. Reforms should be considered that would require some types of companies to withhold on behalf of independent contractors, in cases such as:
 - The independent contractor receives more than \$600 in payments;
 - The freelancer is not an incorporated business;
 - The payer issues 100 or more Form 1099s each year.
- **Establish a standard business deduction for independent workers.** Independent workers must currently track and keep records of all business expenses, such as supplies, vehicle costs and other fees, and subtract against their income. This is a burdensome and complicated process. A standard business deduction in line with personal standard deductions could streamline the deducting of business expenses for solo-entrepreneurs.
- **Pass healthcare tax equity for the self-employed** so that freelancers can deduct their healthcare expenses from their FICA tax obligations—just like other business entities.

Conclusion

Small business owners don't want special treatment in the tax code; they simply want to compete on a level playing field. America's entrepreneurs shouldn't have to navigate a tangled web of tax code to operate and grow their business. This is why we need a tax code that benefits America's entrepreneurs who are focused on growing their enterprises and making payroll at the end of each month. While we missed the opportunity to enact meaningful reform for entrepreneurs last year, there is still much that can be done to benefit our nation's small business owners and encourage more entrepreneurs to follow their dreams, both through ensuring investment in Opportunity Zones lives up to its potential for small business and through further responsible tax reforms.

Thank you for the opportunity to comment on this important issue for America's small business community. I would be happy to answer any questions.